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## INSOL EUROPE Workout Game

**Let's rescue the Utopia Hotel-Casino Group. Or not...?**



*This case is based upon an existing situation. Details are as accurate as possible yet made anonymous. The case is written for EDUCATIONAL PURPOSES and CLASSROOM USE ONLY and is NOT INTENDED FOR PUBLIC DISCLOSURE.*

# Back to the Future...

## *November 2019, somewhere in Utopia*

Welcome to the INSOL EUROPE Workout Game! You are invited to participate in an exciting classroom gameplay. Moreover, you have the challenging task to save a well-known company from Utopia, that employs around 1,500 people. Also, the company is very important for the touristic industry of the country and wider region. Still, you have your own obligations and responsibilities towards the company you work for. Today, the stakeholders are:

- Owners Utopia Hotel-Casino Group company [O]
- Lender [A]
- Lender [B]
- Lender [C]
- Tax Authority [TA]
- Trade Creditors (consortium of two large suppliers) [TC]

### Game play

This game consists of 2 rounds [further instructions are provided during the session]:

**Round 1:** Gather with your new “colleagues” and analyse the case together. Discuss what your position is and what you feel should be the best way forward. You have around **15 minutes** for the group assembly process and preparation with your team members.

**Round 2:** After Round 1 you are invited to join a meeting with all other relevant stakeholders to discuss the situation of the Utopia hotel-casino company and to express your feelings and ideas about how to move forward. The purpose of the meeting is to come to an **informal workout agreement**. There are **60 minutes** available to come to such an agreement including the standstill terms upon which to agree. If an agreement is not reached after these 60 minutes, company management is forced to go to court to file for judicial reorganisation or liquidation proceedings (**bankruptcy!**) as cash by then has almost dried up... (and director’s liability claims should be prevented).

Please bear in mind that all relevant stakeholders are in principle of **good faith** to come to an informal workout agreement. Still, all parties should always keep a close eye on their legal and financial positions.

Are you able and willing to save this company...?

Good luck!

# Case: Utopia Hotel-Casino Group

## Introduction

The Utopia Hotel-Casino Group (hereafter called: “Utopia Group” or “The Company”) is facing a challenging financial situation. With changing market dynamics, the Company’s assets, their three hotel-casinos in Utopia, are losing market share and have started to make substantial losses. Limited financial resources have prevented the Company from making large-scale renovations necessary to compete with new entrants or attract customers from hotel-casino alternatives emerging throughout Utopia and the region. As a result, the Company is in financial distress and does not have enough funds to cover current and future obligations.

## The problem

Utopia Group currently generates positive EBITDA [Operational Profit]. However, the Company is loss making in terms of Net Profits and remains burdened by a high debt load. Current projections show that the Company will not generate enough cash to meet both interest and debt repayment expenses, and its planned Capital Expenditure (Capex). However, an underlying assumption in the projections analysis is that the management team will make headway in improving the Company’s operational and financial health. As such, the projections show gradual operational improvements in the Company’s performance. Specifically, these estimates assume greater efficiency and profitability in day-to-day hotel-casino operations and a positive impact from the Company’s investment in property renovations.

The company is equally owned by a family of three (father, son, daughter) who together represent company management (CEO, CFO, COO).

## A workout or bankruptcy proceedings? That’s the question...

Despite the projected improvements, the Company is not able to meet its current interest and debt repayment obligations to lenders/creditors. Therefore, alternatives need to be considered also because most of the lending agreements will expire soon which basically means refinancing. A workout is necessary soon, otherwise the company needs to file for bankruptcy as cash will dry up and suppliers as well as employees can then not be paid anymore. Besides that, if nothing happens, some of the secured lenders will probably start judicial insolvency proceedings themselves, in order to seize the secured assets (the hotel-casinos) and have them sold (whether or not in a “going concern” sales transaction). The Tax Authority might also initiate seizure actions.

## Alternatives

Ideally, restructuring solutions should increase value for stakeholders, or to put it differently, it should *decrease value destruction* for all. Some possible workout possibilities are presented below each having pros (benefits) and cons for parties involved given the current situation: (not limited)

Workout possibility	Considerations/dilemmas
New Equity Financing	<ul style="list-style-type: none"><li>▪ Current shareholders are not able to inject additional cash</li><li>▪ Current <b>shareholders want to keep the company within the family</b> and do not like the idea of external shareholders</li></ul>
New Debt Financing	<ul style="list-style-type: none"><li>▪ Company is not able to provide first lien securities for such financing as all assets are already secured by (some of the) current lenders</li></ul>

Debt-equity swap	<ul style="list-style-type: none"> <li>▪ Current shareholders will (partly or fully) lose ownership and with that management control</li> <li>▪ Upon agreement, the risk profile increases for secured lenders ('from risk-avoiding capital to risk-bearing capital')</li> <li>▪ Return of investment can be substantial for agreeing creditors if the company manages to make a successful turnaround and resumes making profits</li> </ul>
Debt write-off ("Haircut") by lenders; partial or full	<ul style="list-style-type: none"> <li>▪ Secured lenders will probably not favour such route</li> </ul>
Sale of specific properties	<ul style="list-style-type: none"> <li>▪ Current management will probably not favour such idea as operational economies of scale ("synergies") are then weakened</li> </ul>
Sale of entire company to a new legal entity ("newco") owned by current creditors based on respective economic positions	<ul style="list-style-type: none"> <li>▪ Shareholders lose their company so they will probably not favour such option.</li> <li>▪ Current lenders will only agree when new position ("prospective return") is not weaker than current one</li> </ul>

### Bankruptcy court

In case an informal workout agreement cannot be reached within the current timeframe, there is always the possibility to step into a judicial reorganisation process ("Chapter 11-like process"). Some considerations and dilemmas regarding such alternative in this situation:

<b>Judicial reorganisation procedure</b>	<ul style="list-style-type: none"> <li>▪ Current stakeholders lose control over the situation as judges will step in to decide on the course of proceedings.</li> <li>▪ A public procedure will have a negative effect on the corporate brand-image and will probably lead to substantial cancellations by corporate clients ("events and conferences") and other hotel guests/tour operators. This negative effect can lead to a permanent loss of sales amounting to 30% to 50% of current turnover.</li> <li>▪ The Utopia gaming commission has the legal right to immediately terminate casino licences in case of (judicial) reorganization or liquidation procedures, unless there is a <b>reasonable prospect</b> that the company can be saved (and that won bets by gamblers can be paid out). The commission is known for being '<b>risk-avoiding</b>'.</li> <li>▪ Based on Utopia law, courts can only decide to grant a request for judicial reorganisation, including a so-called automatic stay ("moratorium"), if company management is able to show a <b>reasonable probability</b> that the business can be saved, and that rescuing is a preferable option for all stakeholders as compared to immediate liquidation of the company.</li> </ul>
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### SWOT Analysis

A SWOT analysis for the Company' current operations, recently made by company management, is outlined below.

SWOT Analysis	
Strengths	Weaknesses
<ul style="list-style-type: none"> <li>▪ Strong brand recognition</li> <li>▪ Prime locations</li> <li>▪ Experienced management team who are owners themselves</li> <li>▪ Long established history in Utopia</li> <li>▪ Recent upgrades</li> </ul>	<ul style="list-style-type: none"> <li>▪ Balance sheet limitations</li> <li>▪ Operational inefficiencies versus peers</li> <li>▪ Deteriorating market share</li> <li>▪ Aging buildings in need of renovation</li> </ul>

▪ Land reserve	
<b>Opportunities</b>	<b>Threats</b>
<ul style="list-style-type: none"> <li>▪ Scarcity of hotel rooms</li> <li>▪ Upgrade buildings to attract more high-end customers</li> <li>▪ Expansion into new locations</li> <li>▪ Margin improvement potential</li> </ul>	<ul style="list-style-type: none"> <li>▪ New entrants into the Utopia market</li> <li>▪ Change in regulatory environment</li> <li>▪ Economic downturn</li> <li>▪ Higher cost of debt (“penalties”) due to current financial situation</li> </ul>

### **Financial situation**

Below some information can be found regarding the financial situation and debt structure of the Company as well as expectations (E) regarding profit and cash flow developments for the coming years (USD = US Dollar). Projections are based on a moderate positive scenario. **In a worst-case scenario, the expected turnover should probably be calculated x0.7 (about 30% less than expected in current scenario).** The valuation of the company’s assets (the 3 hotel-casino properties) was recently done by an independent appraiser. “Holding” includes typical head office activities for all hotels, like HR, accounting, purchasing and ICT (all 3 hotel-casinos currently contribute proportionally to Holding costs).

<b>CONSOLIDATED (USD * 1.000)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
Turnover consolidated	130.000	110.000	90.000	80.000	100.000	130.000
EBITDA	10.300	9.000	7.000	4.000	11.000	18.000
Net profit	3.160	-1.800	-1.370	-3.890	880	5.740
Gross margin/sales	70%	69%	68%	67%	69%	72%
Net profit margin	2%	0%	-2%	-5%	1%	4%
Cashflow from operating activities	9.390	6.580	5.310	3.370	8.330	13.240
Cashflow from investment activities	-7.000	-6.000	-5.000	-4.000	-8.000	-10.000
Cashflow from financing activities	-2.490	-2.550	-2.600	-2.600	-2.600	-2.600
Net cashflow	-100	-1.980	-2.290	-3.240	-2.280	640
Balance sheet total	229.780	254.780	252.230	319.700	272.200	223.200
Solvency (%)	22%	20%	20%	17%	20%	22%
Current ratio	37%	33%	32%	29%	33%	41%

<b>HOLDING (USD * 1.000)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
Turnover consolidated	0	0	0	0	0	0
EBITDA	-3.120	-2.680	-2.170	-1.980	-2.320	-3.020
Net profit	-3.930	-3.810	-3.300	-3.200	-3.440	-3.940
Gross margin/sales	N/A	N/A	N/A	N/A	N/A	N/A
Net profit margin	N/A	N/A	N/A	N/A	N/A	N/A
Cashflow from operating activities	-3.680	-3.540	-3.030	-2.910	-3.140	-3.640
Cashflow from investment activities	-350	-300	-250	-200	-400	-500
Cashflow from financing activities	-2.490	-2.550	-2.600	-2.600	-2.600	-2.600
Net cashflow	-6.520	-6.390	-5.880	-5.710	-6.140	-6.740

<b>HOTEL MASTER (USD * 1.000)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
Turnover consolidated	46.800	38.500	32.400	29.600	36.000	45.500
EBITDA	8.190	6.950	8.570	5.690	8.680	13.790
Net profit	4.080	3.070	4.220	2.050	4.090	7.660
Gross margin/sales	76%	79%	85%	78%	81%	88%
Net profit margin	9%	8%	13%	7%	11%	17%
Cashflow from operating activities	6.440	5.630	6.760	4.810	6.930	10.510
Cashflow from investment activities	-2.800	-2.400	-2.000	-1.600	-3.200	-4.000
Cashflow from financing activities	0	0	0	0	0	0
Net cashflow	3.640	3.230	4.760	3.210	3.730	6.510

<b>HOTEL OAK (USD * 1.000)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
Turnover consolidated	44.200	39.600	32.400	28.000	35.000	45.500
EBITDA	4.550	4.670	3.060	1.940	4.540	6.300
Net profit	1.790	1.760	650	-270	1.510	2.730
Gross margin/sales	72%	71%	68%	69%	71%	72%
Net profit margin	4%	4%	2%	-1%	4%	6%
Cashflow from operating activities	3.780	3.920	2.780	2.050	3.890	5.130
Cashflow from investment activities	-2.450	-2.100	-1.750	-1.400	-2.800	-3.500
Cashflow from financing activities	0	0	0	0	0	0
Net cashflow	1.330	1.820	1.030	650	1.090	1.630

<b>HOTEL GOLD (USD * 1.000)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
Turnover consolidated	39.000	31.900	25.200	22.400	29.000	39.000
EBITDA	3.380	60	-2.460	-1.640	100	940
Net profit	1.230	-1.180	-2.940	-2.470	-1.290	-710
Gross margin/sales	61%	55%	46%	50%	52%	53%
Net profit margin	3%	-4%	-12%	-11%	-4%	-2%
Cashflow from operating activities	2.850	570	-1.200	-580	650	1.240
Cashflow from investment activities	-1.400	-1.200	-1.000	-800	-1.600	-2.000
Cashflow from financing activities	0	0	0	0	0	0
Net cashflow	1.450	-630	-2.200	-1.380	-950	-760

#### Current debt structure

<b>Stakeholder</b>	<b>Term loan</b>	<b>Outstanding</b>	<b>Expiration date</b>	<b>Arrears in interest payments</b>	<b>Arrears in debt repayment</b>
Senior debt (secured) Lender [A] (first lien)		69.370	1 January 2020	Yes	Yes
Senior debt (secured) Lender [B] (second lien)		59.460	1 January 2020	Yes	Yes

Working capital facility (unsecured) Lender [C]		9.910	1 December 2019	No	N/A
Tax Authority [TA] (unsecured but right to seize assets)	N/A	17.930	Immediately	N/A	Yes
	The Tax authority in Utopia has a legal right to seize all current assets of a company in case of arrears in payment (in case of this company about 10% of total assets). In practice, the authority is willing to negotiate a workout deal for social reasons (e.g., employment retention) under the restriction that management is honest, and all other creditors are also willing to work on a solution that represents the legal and economic interests at stake in a fair way. In case of a 'haircut' she only accepts an offer that is twice the percentage that ordinary creditors are willing to accept (e.g., in case ordinary creditors accept 25% of the outstanding debt and write off 75%, the tax authority will accept 50% and thus writes off 50%). <b>Utopian tax inspectors are known to be "tough cookies" in negotiations as they distrust commercial lenders in general.</b>				
Secured debt provided by shareholders [O] (first lien, "pari-passu" with [A])		10.000	1 January 2020	No	No
Trade creditors [TC] (unsecured)	N/A	48.510	Company currently pays on average after 120-150 days	Payment shall be received 30 days from date of invoice according to contract terms	
	The two trade creditors that are at the negotiation table today can be considered crucial for the company's operations as they supply food & beverages (F&B) and daily cleaning services. It is hardly possible to switch to other such suppliers within 30 to 60 days as current suppliers (who represent about 95% of current trade debt) can be considered monopolists in the high-end hotel-casino industry. Also, new suppliers will probably demand substantial guarantees or cash-on-delivery.				

### Valuation of the Company's assets (3 hotel-casino properties)

The valuations are based on the assumption that the hotel-casino properties can be sold relatively quick to e.g., a strategic or financial investor. Whether that is the case in practice remains to be seen and is also dependent on the negotiation skills and business connections of the seller.

VALUATION SCENARIOS (USD * 1.000)	Out-of-court restructuring (going concern scenario)	Bankruptcy reorganisation proceeding (going concern scenario)	Liquidation (going concern scenario)	Liquidation (piecemeal sale of assets; not going concern)
Total Group <sup>1</sup>	216.000	101.250	56.160	39.312
Hotel Master	132.360	62.050	34.416	24.091
Hotel Oak	60.480	28.350	15.724	11.006
Hotel Gold	8.990	4.210	2.336	1.635

<sup>1</sup> In case of a Total Group sale a surplus is expected, in any scenario, above the total value of the three individual assets.